

WHAT DOES BEING ON THE “WATCH LIST” MEAN?

It is important that you understand what it means to be on the watch list and, perhaps more importantly, what it does not mean. Being on the watch list, as the name would imply, simply means we believe there is good reason to watch this fund more closely. Being on the watch list does not mean you should immediately sell your fund shares. It is not unusual for a fund to appear on the list from time to time. It does not mean the fund is necessarily a bad investment. If we believe the fund no longer represents a suitable investment option, we will remove the fund from the Plan.

Why are funds placed on the watch list?

Funds can be placed on the watch list for several reasons. Why a fund is on the watch list is more important than the mere fact that it is on the watch list. The most typical reasons are as follows:

1. **Performance**—The most common reason a fund is placed on the watch list is poor performance relative to its appropriate market benchmark and/or peer group. When signs of relative underperformance appear, we place a fund on the watch list.
2. **Risk**—Less obvious to many participants is the risk that a fund manager incurs. If a fund becomes too volatile, we will place it on the watch list.
3. **Risk-Adjusted Returns**—What returns has the fund manager been able to deliver relative to the risk the fund has incurred? If the manager is unable to deliver adequate returns for the risk taken, we will place the fund on the watch list.
4. **Portfolio Construction/Style Drift**—Is the fund manager investing the money in the way he or she said? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stocks of small, growth-oriented companies, then you want the manager to do just that. We monitor the manager's portfolio and if the security holdings do not reflect what has been communicated, we place the fund on the watch list.
5. **Operations**—There are many operational reasons for placing a fund on the watch list. For example, the manager of the fund could leave. Remember, when you purchase shares of a mutual fund, what you are really doing is hiring a professional portfolio manager to invest your money. If that manager leaves, you should watch the fund closely. There could also be firm-level issues. These can include issues such as regulatory violations, turnover in senior management, or a merger or acquisition. Any of these operational issues will automatically place a fund on the watch list.

WATCH LIST—THE STATE OF ILLINOIS DEFERRED COMPENSATION PLAN

Current Watch List Summary

The following funds are on the watch list as of 6/30/2009:

The Plan recently retained a new investment consultant and as a part of the due diligence process will be performing an in-depth review of all of the investment options to ensure participants have access to the highest quality fund options.

Ariel Fund: The Fund's performance for the quarter was strong relative to its peer group as it ranked in the 5th percentile of mid-cap equity funds. The Fund's performance for the year-to-date has also showed much improvement as it ranks in the 21st percentile. Individual holdings, such as CB Richard Ellis and Royal Caribbean, have been the source of the fund's most recent success. The Fund's longer-term performance however, has lagged its benchmark and its peer group. Participants also have access to the Northern Small-Cap Value Fund which invests in a small-cap value equity style. This Fund will remain on the watch list due to longer term underperformance and pending the outcomes of the review.

Legg Mason Value Trust: This fund also showed signs of significant improvement as it handily outpaced its benchmark and peer group over the quarter. The Fund returned an impressive +29.3% and ranked in the 3rd percentile of its peer group universe. Key contributors to this outperformance were strong stock returns in the utilities, financials, and consumer sectors. Overall, only 4% of their holdings detracted from performance over this period. Holdings such as utilities company AES and consumer companies Sears and eBay posted gains of +100%, +46%, and +36% respectively. However, longer term this Fund's performance continues to lag its peer group and the benchmark. An alternative fund for participants to access is the Vanguard S&P 500 Index Fund as it invests in similar stocks to the Legg Mason Fund. This Fund will remain on the watch list due to longer term underperformance and pending the outcomes of the review.

Fidelity Puritan: This Fund had a recent change to its underlying lead portfolio manager which occurred in February of 2007. As a result of this change, the Fund was placed on watch. Since that change, the Fund has performed close to the median of its peer group ranking in the 46th percentile over the one year period. The Fund keeps the allocation of stocks to bonds fairly tight to the target of 60% stocks and 40% bonds. A slight underweight to equities detracted over the quarter as equities posted significant gains, but an overweight to financial issues in the equity portfolio added value as many banks were rewarded for improved credit markets. This Fund will remain on the watch list due to the recent manager change and pending outcomes of the review.

LSV Value Equity: Performance over the past few years resulted in this Fund's watch status as it underperformed its benchmark and its peers. As quality stock fundamentals were rewarded over the quarter for funds with a large-cap value style, this Fund significantly outperformed. Prior to this quarter, this style of investing was not rewarded. The Fund ranked in the 29th percentile of its peer group for the quarter. This Fund will remain on the watch list due to longer term underperformance and pending the outcomes of the review.

Insight



A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW

PSYCHOLOGY AND INVESTING

If you've ever chased a hot investing trend, you're not alone. A branch of economic research called behavioral finance theorizes that this and other common investing missteps can be traced to the way our brains function. Understanding a few key principles of behavioral finance could help you recognize—and potentially avoid—some all-too-human tendencies in the future.

Following the Crowd

As they seek to build savings, investors encounter a variety of psychological roadblocks—starting with one called “herd behavior.”¹ That's the tendency for individuals to do what others are doing, even though it may not be appropriate. Here are some other ways your emotions can lead you astray—and ways to guard against them:

Confirmation bias: Having more confidence in information that supports your thinking than in information that challenges it. This, in turn, can lead to herd behavior: simply following the crowd instead of doing your own research.²

Guard against confirmation bias by gathering as much information as you can. You might even consider discussing your options with a professional financial planner.

Overconfidence: We assume we are better at a task than we are—such as picking the best funds and the best times to buy and sell those funds. Remember that it's impossible to know everything about any given investment, just as it's impossible to predict how the market will perform.²

Avoid overconfidence by taking advantage of your plan's systematic approach to investing. If you invest the same amount each month in mutual funds managed by seasoned professionals, you may be less tempted to try to time the market.

Anchoring: We often make decisions using irrelevant criteria. Imagine you invested in a mutual fund at \$20 a share, and the fund's share price is now \$10. Instead of accepting your loss, you fixate on

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Save the Date!

COLUMBIA ACORN FUNDS ANNUAL SHAREHOLDER INFORMATION MEETING

When: Wednesday, September 30, 2009
12 noon to 1 p.m. Central time

Where: Chase Bank Auditorium, Plaza Level
10 South Dearborn Street
Chicago, IL 60602

A buffet lunch will be served at 11:30 a.m.

A webcast replay will also be available following the meeting at www.columbiafunds.com. Look for additional details in our semiannual report to shareholders.

Please RSVP by September 25 if you plan to attend by calling (800) 922-6769.

Janus Fund Names Change

Effective July 6, 2009, the Janus Funds reorganized a number of their mutual fund offerings, resulting in changes to certain fund names. While the investment objective and ticker symbol (JIGFX) remain the same, the Janus Advisor International Growth is now called the Janus Overseas CL, I.

For more information on these changes, please visit the myRetirementPlan Web site at rps.troweprice.com.

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the price you originally paid, and vow not to make a change until the shares again reach \$20.²

Guard against anchoring by having firm rules—and acting on them. For instance, if one of your investments underperforms comparable funds for a year or more, you might consider moving those assets into a different fund, even if that means accepting a loss.

Prospect theory: First detailed in 1979 by psychologists Amos Tversky and Daniel Kahneman, prospect theory examines investors' expectations of gains and losses. One key finding: Investors prefer a sure gain over the chance of no gain, but they prefer the chance of avoiding a loss rather than taking a definite one, albeit smaller.

In an experiment, students were asked to choose between a 100% chance of receiving \$3,000 and an 80% chance of winning \$4,000. Most said they would take the \$3,000—a rational decision, since that scenario involves little risk. But when the scenario was reversed—a choice between a 100% chance of losing \$3,000 and an 80% chance of losing \$4,000—the majority said they would rather risk taking the larger loss.²

Maintaining an appropriate blend of stocks, bonds, and money market/stable value investments for your time horizon (see “Financial Dictionary” on page 4) can help you to stay focused on the long term.

A Rational Path

The market's recent dramatic downturn may have rattled your nerves, and that's perfectly natural. Remember that saving for retirement is a long-term process, so try to let reason—not emotion—drive your investment decisions.

¹ “Behavioral Finance,” Professor Jay R. Ritter, *Pacific-Basin Finance Journal*, September 2003.

² “Behavioral Finance: Key Concepts” investopedia.com.



LEARNING SAVVY SAVING

It's never too early to teach your children about money. Your 457 Deferred Compensation Plan can serve as a valuable teaching tool. By explaining how the plan works, you can help your child understand the basics of saving and investing.

Here are some age-based tips to help you begin:

Ages 4-7

Discuss the basics of earning and spending, and explain how money works. On a trip to the grocery store, for example, you might let your child help to make some basic spending decisions.

Ages 8-10

If your child receives an allowance, explain the importance of saving money to make a larger purchase. You might point out how your 457 plan helps you to save for the future, just as your child might set aside some of his or her allowance.

Ages 11-12

By this time, your child should understand the basics of earning, saving, and spending. When he or she has \$20 or more saved, consider opening a bank account for your child. Birthday or holiday gifts from grandparents can help to build your child's savings, and you can explain concepts such as interest and compound growth.

Age 13 and beyond

To help prepare your teenager for adult responsibilities, begin explaining some basic investing concepts. Help your teen track the investment markets with you. Choose a company that interests him or her, such as a video gaming or entertainment firm, and track its stock's share price for a year or more to illustrate the importance of a long-term approach to investing. Discuss long-term investment plans like 457 plans and college savings plans.

With a little guidance, you can put your children on the path to financial independence. It may be the most valuable gift you can give them.

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EXPAND YOUR INVESTING VOCABULARY FINANCIAL DICTIONARY

Get to know the following terms from this issue of Insight:

Behavioral finance

A branch of economic research that studies how individuals evaluate information as they make investing decisions.

Social Security benefit

This is the retirement benefit paid to workers by the Social Security administration. Retirees' benefits are calculated according to their earnings during their working years.

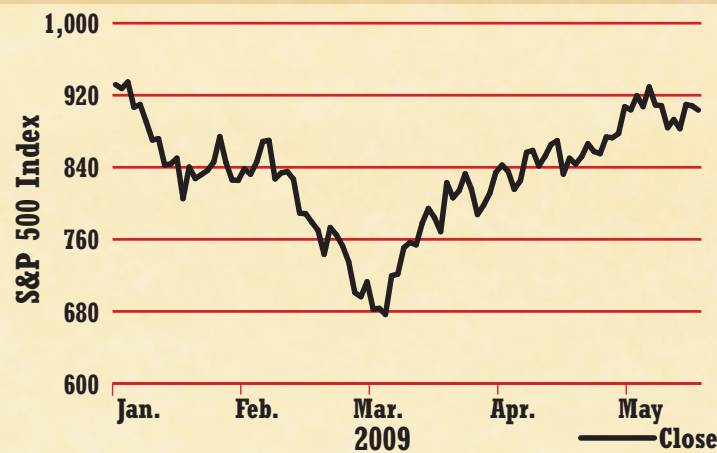
Time horizon

The amount of time until you reach a financial goal, plus your time frame for withdrawing the money. For example, if you plan to buy a new home in 2014, your time horizon is five years, because you'll spend your savings in a single day.

HOPEFUL SIGNS FOR STOCKS

The economy is still in recession, but a number of the indicators that shape the economic outlook have improved, giving hope that the worst of the slump may be over. That's no guarantee recovery is just ahead, but it's a promising sign.

For investors, one of the most painful aspects of the current recession has been the prolonged bear market. However, stock market performance (as measured by the S&P 500) is one of the 10 leading economic indicators, and since hitting a 12-year low in early March, the S&P 500 has recovered more than 35%.¹



Gains in Real Estate and Consumer Confidence

Another major component of the downturn was the collapse of the housing market. However, contracts to buy homes rebounded significantly in March, thanks to first-time buyers taking advantage of depressed prices. That raised investor expectations of a recovery in the real estate market.²

Still another positive indicator was the recent increase of consumer confidence in the economy to its highest level so far this year. The percentage of consumers expecting business conditions to improve over the next six months increased by more than 60% through early May.³ A recovery in consumer spending is especially important to the economic outlook because consumers generally account for more than two-thirds of all spending in the economy.⁴

Maintaining Your Focus

While these recent developments may be reason for cautious optimism, there is no telling how long it will take for the economy or the stock market to recover completely. A sharp rally in stock prices from March into May could eventually confirm a historical trend that some of the market's biggest gains come long before a recession itself comes to an end. For retirement investors, the lesson remains: Make sure you have chosen an asset allocation appropriate for your time horizon and stick to it.

¹ msnbc.com, May 26, 2009.

² National Association of Realtors, May 4, 2009.

³ The Conference Board Consumer Confidence Survey, May 26, 2009.

⁴ Gross Domestic Product: First Quarter 2009 (Advance), Bureau of Economic Analysis, National Income Accounts, April 29, 2009

TEST YOUR KNOWLEDGE OF SOCIAL SECURITY

Nearly 51 million Americans will receive \$650 billion in Social Security benefits in 2009, according to the Social Security Administration. Take this quiz to see how much you know about this retirement benefit.

1. My Social Security benefit is based on the income of my five highest-earning years.
☐ True ☐ False
2. The average monthly Social Security benefit for a retired worker paid in 2009 will be about \$1,100.
☐ True ☐ False
3. Although you can collect a Social Security benefit at age 62, your monthly benefit will be greater if you delay until you reach age 70.
☐ True ☐ False

Answers

1. **False.** Social Security uses a complicated formula to calculate your benefit, based on your 35 highest-income years. You can estimate your future benefit online, based on your actual earnings record, at www.socialsecurity.gov/estimator.
2. **True.** The average monthly benefit for all retired workers in 2009—after a 5.8% cost-of-living adjustment—is \$1,153. The maximum benefit for a worker retiring at full retirement age—currently 66—is \$2,323.
3. **True.** Your benefit can increase by up to 8% a year for each year between ages 62 and 70 that you delay collecting the monthly payments.

Source: ssa.gov.

TELEPHONE NUMBERS

Deferred Compensation

Plan Rules/Options Information

800-442-1300/ 217-782-7006

TDD/TTY: 800-526-0844

Internet: <http://www.state.il.us/cms/employee/defcom>

Recordkeeper

T. Rowe Price Retirement Plan Services, Inc.

Account Value Information and Investment Changes:

888-457-5770 or TDD/TTY: 800-521-0325

Internet Access: 800-541-3022

Internet: <http://rps.troweprice.com>